

# **AN EVALUATION OF THE DEVELOPMENTAL IMPLICATIONS OF THE WORLD BANK AND *IMF* LENDING POLICIES**

*By*

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*Over the years, development has, both in concept and practice, traversed through several evolutionary stages in consonance with the inadequacies that characterised the series of paradigms that emerged at different epochs. All propositions on development converge on the provision of basic needs such as food, education, health, shelter, safe drinking water as the fundamentals of societal development. The World Bank and IMF have firmly taken the centre stage as the global agents for generating development, through project loans financing, that are usually hinged on policy framework and implementation arrangements that are designed by them (World Bank and IMF). This paper is an incursion into the operational principles of these formidable global lenders in juxtaposition with the essentials of development, so as to explore a measure of the efficacy of their strategies in spearheading development of underdeveloped countries.*

## **INTRODUCTION**

The World Bank (International Bank for Reconstruction and Development) and the IMF (International Monetary Fund) both originated and continue to thrive on the philosophy of providing the necessary requirements for the development of underdeveloped economies. However, the most shrouded issue in contemporary development analysis is the efficacy of the developmental functions of these institutions, which are, in conjunction with the WTO (World Trade Organisation), the cardinal fibre of the globalisation process.

The activities of these International Financial institutions are therefore expected to facilitate the process of economic development. Since their establishment after the Second World War, in recognition of the need to finance the reconstruction of the effects of the war, the World Bank and the IMF have engaged in several credit financing projects that have impacted on the economic fortunes of several countries of the world. Based on the experiences of different various countries of the world the, the activities of these formidable international financial institutions have generated discontents, especially among the countries whose relationship with them is believed to have contributed to the chronic lack of growth and development of their economies. The Breton Woods

institutions, as they are fondly called, are believed to have played a dominant role in strengthening and sustaining the lopsided process of globalisation that has made poor countries poorer and richer countries richer (Stiglitz, 2002). The 1999 Human Development Report warned that globalisation may actually increase human insecurity and marginalise the poor.

The philosophical foundation of the World Bank and the IMF on one hand, and the actual contribution of them to development of underdeveloped countries, manifested by a widening disparity between the developed and the underdeveloped countries, on the other, are contrasting. This poses pertinent challenges to the World Bank and IMF and has rekindled a thorough scrutiny of the issues embedded in economic development theory. There is an increasing urge to resolve the development puzzle arising from the role of international agents of development in a global economic system that is driven by the spirit of commerce and expansion of markets. The remaining part of this paper is organised as follows; section two will dwell on the essential requirements of economic development and the role of international credit; section three will be an incursion into the operational principles and strategies of the World Bank and IMF; section four will be an analysis of the implication of the World Bank and IMF to economic growth and development of underdeveloped countries and section five will be conclusion.

## **THE ESSENTIALS OF ECONOMIC DEVELOPMENT AND THE ROLE OF INTERNATIONAL CREDIT**

Development economics has traversed several clusters of ideas over the years, all in attempts to mould a process (model) that can be applied to attain development by different societies (countries) of the world. This has culminated into revolutions and counter-revolutions in development theories (Krugman, 1992). In the evaluation of what

he termed “high development theory”, Paul Krugman traced the ideas of Paul Rosenstein-Rodan, Albert Hirschman and others who emphasized the increasing returns and pecuniary external economies that arise from the effects of market size, arguing that these important ideas faded from mainstream economics not because of intrinsic logical flaws but because the authors failed to codify their ideas in internally consistent, formal models and also as a result of the neo-classical counter-revolution against interventionist development models.

Krugman’s exposition, apart from re-echoing the diverse propositions of economic development, has generated a more rigorous discourse of development and international economics, growth theory, and industrial organisations, which gave rise to the need for a “counter-counter revolution” that, would seek a middle ground between the extremes of a free market orthodoxy and state control. Economic development entails sustainable growth, poverty reduction, human development, environmental protection, institutional transformation, gender equity and human rights protection. The ultimate aspirations of modern societies is the upward movement of the entire social system of a country. More poignantly, development is the attainment of a number of ideals of modernisation such as rise in productivity, social and economic equalisation, modern knowledge, improved institutions and attitudes, a rationally co-ordinated system of policy measures that can remove the host of undesirable conditions in the social system that has perpetrated a state of underdevelopment.

Researchers and policy makers are rediscovering as we move from the decades of adjustment to a new period of reform and growth, the two most important principles of development; one being that during the early phases of development when an economy is no more than a collection of fragmented markets and region, the establishment of government institutions, the construction of infrastructure and the direct participation of the state in key areas of the economy are not only desirable but indispensable preconditions for the growth process; the second principle reflects the notion of the opening-up of investment opportunities through changes in the environment where individuals work, save and invest, in the process of which a basis for new ideas and

investment opportunities are created ( Aspe and Gurria, 1992). Proper application of ideas is very crucial in the development process, which Romer (1992) incorporated as a factor of production and contrasted alternative development strategies based on using existing ideas and producing ideas.

An essential precondition for economic development is economic growth. Kuznets (1971)<sup>1</sup> defined economic growth as “a long term rise in capacity to supply increasingly diverse economic goods to its population; this growing capacity is based on advancing technology and the institutional and ideological adjustments that it demands” (Todaro, 1994). Increases in the outputs of major sectors of an economy, such as manufacturing and natural resource, either as a result of increases in the use of inputs or improvement in technology, will lead to economic growth. Key macroeconomic indicators such as the gross national product (GNP), gross domestic product (GDP) and net national product (NNP) are used, among other economic parameters, as measures of economic growth performance of an economy. A progressive increase in the outputs of major sectors of an economy is a manifestation of the attainment of economic growth.

Basically, economic growth is driven by a process that is generated and sustained by the effective utilisation of a country’s economic resources. The challenge facing countries in attaining economic growth is that of creating an enabling atmosphere for essential use and the harnessing of economic resources. This challenge has become even more intensified by an increasingly interdependent global economic dispensation that tends to undermine and marginalise indolent economies. This has given rise to disparities among countries of the world in terms of their levels of attainment of economic growth. While some countries have achieved high rates of economic growth, which have led to enhanced standard of living within such countries, other countries of the world have performed dismally, attaining little, and in some cases nothing in terms of economic growth which translates into very low standard of living of their citizenry. Some economies have witnessed a sudden and remarkably very high growth rates even above

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<sup>1</sup> Kuznets, (1971) Modern Economic Growth: Findings and Reflections, Nobel Lecture delivered in Stockholm, Sweden and Published in the American Economic Review, 63, September, 1973.

the world average. This achievement is being referred to as growth miracles. On the other hand those economies that have performed abysmally below world average are referred to as growth disasters. Real productive activities engender economic growth by ensuring a continuous improvement in the methods of production, discovery of new resources and thus creating the necessary conditions for effective utilisation of resources. A multiple sector positive performance is essential for the growth of the overall economy, but a sector of the economy that attracts higher levels of economic activities could stimulate the productive fibre of other sectors towards real production and provide the requisite impetus for sustainable growth of the economy.

The various models of economic growth, which are broadly categorised into classical and endogenous growth models (McCallun, 1996), illuminate the crucial essence of the effective use of factors of production as the veritable mechanism for attaining economic growth. The significant deduction from the convergent expositions of the models is the crucial role of technology as the catalyst for economic growth based on the stimulating and complementing role of production and consumption, as a necessary condition for sustainable growth. Production is meant to provide for consumption, which originates from the urge of the household to consume to attain welfare. Since the more the better, the insatiable motivation to improve on the variety, quantity and quality of consumption leads to discoveries of more sophisticated methods of production, through which technology is derived and acquired to form the bedrock of economic growth. A co-ordinated institutional motivation for effective utilisation of resources is therefore a fundamental condition for generating a sustainable growth path.

A synthesis of the endogenous growth models (see for instance, Sandilands, 2000) points to the fact that the existence of industrial production on one hand, and demand for the products of the industries on the other hand, creates opportunities for market expansion, competition and specialization. Through a favourable “forward linkage” effects, an endogenous self-perpetuating process of growth emerges and feeds on it almost automatically. By the prompting of internal and external economies of scale, the process of industrial production evolves into higher and more sophisticated levels of production,

giving rise to further specialization, new products and quality improvements, leading to technological acquisition and economic growth. Adaptation to a growing market, widened by international trade, stimulates industrial production and provides additional impetus to the attainment of economic growth. The dimension of international trade has given rise to the contemporary challenges posed by globalization. The export-led economic growth hypothesis is hinged on the stimulation of production as a result of larger demand arising from international trade, which induces economies of scale. This hypothesis was inspired by much earlier trade-led growth expositions by classical economists such as Adam Smith and David Ricardo. Thus, industrialization-driven resource utilization process is the key to economic growth, in that industrialization ensures production and generates positive externalities for spearheading the economic growth path. However, the process of globalization has given rise to greater competition towards markets and investments.

Economic development springs-up from economic growth in that the process of generating economic growth give rise to the attainment of basic elements of development and amplifies the urge for further development. Development is like a jigsaw puzzle; it is easier to fit in a particular piece when the adjoining pieces are already in place. Once the difficult parts of the puzzle have been solved, the remaining pieces begin to fall into place almost automatically. Ohiorhenuan (200) asserts that the most striking aspect of the evolution of development thinking over the last fifty years is the growing acceptance that development is a journey, not a destination, and that the process may be more important. Although development has universal principles, each society (country) of the world requires adopting different approach based on its inherent peculiarities to initiate and sustain the process of development.

The fundamental convergent proposition on development is the provision of basic needs such as food, education, health, safe drinking water and shelter to the citizenry. It is also widely accepted that this task is better and more appropriately performed by public institutions. This underscores the critical role of the government in the process of economic development. Public expenditure is expected to stimulate the factors of

production towards effective utilization of resources, enhancement of the value-adding capacities of the factors of production and thus generating the process of sustainable growth and development of the economy. The role of public expenditure evolves in the course of development since the fiscal machinery is hinged on the changing needs of the economy, which presupposes that expansion in public expenditure reflects in the growth of the economy in consonance with the varying allocation and distribution needs of the economy. The economic and social progress of any economy depends largely on its government's ability to generate sufficient revenues to finance an expanding programme of essential, non-revenue yielding public services (Todaro, 1994). The government activity or public expenditure version of endogenous growth model argues that various activities of government such as provision of infrastructure services, the protection of property rights and taxation policies could affect the level of baseline technology and thus affects the long-run per capita growth rate. Assuming there is no population growth, the economy can exhibit endogenous growth as a result of contingent pattern of public expenditure. This implies that public services are complementary with the private inputs in the sense that an increase in government expenditure raises the marginal products of labour and capital to individual firms. It is assumed that government purchases a portion of private output, which it uses to provide free public services that is non rival and non excludable. Firms benefit from this and thus maximises profit by equating the wage rate, which equals the after tax marginal product of labour, with the rental rate, which equals the after tax marginal product of capital, which enhances the aggregate output of the economy. Government maximises the representative consumer's inter-temporal utility based on the social optimal growth of the economy. Through the principle of "scale effect", an increase in labour raises the after tax marginal product of capital and expands the social marginal product in a parallel way, which in turn, leads to higher per capita growth rates. However, congestion on government services affects production negatively and retards growth of the overall economy invariably. If a public good is used by more than necessary number of firms, congestion sets in and this leads to inefficiency of the production process.

Adequate provision of basic needs of the society through the state-controlled machinery of government motivate private investments, which enhance the productivity of the factors of production and leads to growth and development of the economy. The state has a great responsibility in creating favourable conditions for the interplay of societal forces and directing the economic dispensation towards a path of growth and development. Given that development is a process not an event, the role of the state is continuous and does not end at a given level of economic development even though the scope and nature of such roles may change to reflect the intricate dynamics of society. The key to development is the continuing development of human resources and their involvement in creating and using ideas in the economic, social and political dispensation of the society. The social and material condition of individuals within the society should be paramount in policy articulation and implementation. Thus, development is an inclusive process that entails the aspirations of the people of a given society, who are more familiar with their environment; as such can more appropriately diagnose their problems, articulate their vision and design solution for any identified problem of their society. A co-ordinated institutional motivation for effective utilisation of resources is therefore a fundamental condition for generating a sustainable economic growth path that leads economic development.

Essentially, economic development process is triggered by the coordination ability of the state (government institutions) to generate revenues to finance a wide range of projects that could satisfy the basic needs of the society. The state needs to perform the strategic functions of planning, allocation, distribution and stabilisation to ensure that the implementation of its programmes are in tandem with the basic needs of the society and the resources of the society are rationally and optimally used for the purpose. This triggers a chain of activities that leads to multiplier effects on the society through the enhancement of the capabilities of the society and improvements in the value of services derived from the process. The initial preconditions necessary for effective take-off of the economic development process has very slow rate of returns on investment so is not profit-yielding and commercially driven. It requires to be nurtured over a period of a long



span of time that could spring up several benefits to the society. Development forces respond automatically when the basic prerequisites are established.

In most cases, government of countries realise in the process of implementing their planned development projects that, the financial resources needed to be committed to actualise the basic ingredients of the vision of development is far more than what is available domestically. This means that there a financial resource gap that limits the process of attaining economic growth and development. The desire to achieve the overriding goal of economic development necessitates the recourse to international credit to fill the gap created by the inadequacy of domestic financial resources. This strategy has been used by several countries, including the developed countries at their different stages of development. Given the slow rate of returns of investment associated with development projects, loans acquired to finance such projects should not be commercially driven if it is to serve the purpose of achieving development goals of the countries.

### **THE OPERATIONS OF THE WORLD BANK AND IMF**

The end of the Second World War gave birth to both the World Bank and the IMF under the auspices of a UN Monetary and Financial Conference at Bretton Woods, New Hampshire, in July 1944 based on the need to finance the reconstruction of the devastation of the war in Europe and also save the world from future economic depressions. This mission reflects the actual name of the World Bank-the International Bank for Reconstruction and Development. The World Bank was assigned mainly the responsibility of reconstruction and development while the IMF was to ensure global economic stability to avert a repeat of the Great Depression of the 1930s which engulfed the entire world and led to unprecedented rise in unemployment.

The functions and operations of these two formidable international financial institutions has evolved over the years are now playing crucial roles in the development agenda of several, if not all, countries of the world. Officially, the fundamental objectives of the World Bank and IMF remain the same but several changes has occurred in the way and manner the objectives are pursued. Both the World Bank and the IMF stipulates the

hallmark of their operations as development financing and stability of the economies of countries of the world but the strategies being adopted to achieve their goals requires the fulfilment of certain conditions by beneficiary countries. Boxes one and two are extracts of the conditions to be met by potential beneficiary countries.

### **BOX 1: WORD BANK PRINCIPLES OF OPERATION**

Projects supported by the World Bank are designed to carry out national poverty-reduction strategies. The Comprehensive Development Framework governs the development of those strategies. Presented to the World Bank Board of Governors in 1998, the framework spells out four principles, all of which mark significant shifts in thinking about development since the 1990s:

- *Development strategies should be comprehensive and shaped by a long-term vision.* In the past, development strategies emphasized short-term macroeconomic stabilization and balance-of-payment corrections. The CDF stresses longer-term structural and social considerations, such as expanding and improving education and health facilities, maintaining infrastructure, and training a new generation of public officials.
- *Each country should devise and direct its own development agenda based on citizen participation.* The CDF holds that when countries “own” reforms, governments and their citizens are more committed to seeing them through.
- *Governments, donors, civil society, the private sector and other stakeholders should work together in partnership led by recipient countries to carry out development strategies.* Partnerships built on transparency, mutual trust and consultation can increase the efficiency and effectiveness of aid, and help countries increase their capacity to develop and carry out a wide variety of programs.
- *Development performance should be evaluated on the basis of measurable results.* Traditionally, the Bank tended to concentrate on disbursement levels and project inputs in evaluating development efforts, an approach that measured only resource allocation and consumption. The CDF emphasizes that evaluation should focus on the impact of aid on people and their needs.

Source; The World Bank; [www.worldbank.com](http://www.worldbank.com).

## **Box 2: The IMF's Lending Mechanism**

**Members draw on the Fund's pool of resources through a purchase-repurchase mechanism.** A member using its reserve tranche position or obtaining credit from the Fund "purchases" from the Fund either SDRs or the currency of another member in exchange for its own currency, and repayment of the credit is effected by a "repurchase," a reversal of the original transaction.<sup>1</sup> By design of the Fund's financing mechanism, the currency purchased must be that of a creditor country, i.e., one with a strong external position, whose subscribed currency is considered usable for Fund transactions.

**A member's purchase of currency reduces the Fund's holdings of the currency purchased, enlarges the reserve tranche position of the country whose currency is purchased, and increases the Fund's holdings of the purchasing member's currency.** Consequently, members' purchases and repurchases change the composition but not the SDR value of the Fund's pool of resources. In planning and executing members' transactions, the Fund uses currencies in a manner that adjusts creditor members' reserve tranche positions toward a uniform proportion of their quotas. In other words, creditor members participate in the financing of Fund lending according to their relative quota shares.

**The usability (liquidity) of the Fund's pool of currencies is ensured by established conversion procedures.** All members are obliged to ensure that their currencies (held by the Fund and potentially transferable to a borrowing country in a Fund purchase) are either balances of a freely usable currency or can be converted into such a currency.<sup>2</sup> These arrangements help to meet a drawing member's preference for currency it wishes to purchase.

<sup>1</sup> This financing mechanism has its roots in the credit facilities that existed between central banks before the Fund was established. In making a purchase, the member provides domestic currency to the Fund *additional to*

currency previously paid to the Fund for the member's subscription.

A freely usable currency is one that the Fund determines is widely used to make payments for international transactions and traded in the principal exchange markets. At present, the freely usable currencies are the U.S.

dollar, euro, Japanese yen, and pound sterling. See *Proposed Second Amendment to the Articles of Agreement of the International Monetary Fund: a Report by the Executive Directors to the Board of Governors*, Washington,

D.C., 1976, pp. 23-25; and Joseph Gold, "Use, Conversion, and Exchange of Currency Under the Second Amendment of the Fund's Articles," Pamphlet Series No. 23 (Washington: IMF, 1978), esp. p. 2, and pp. 68-

### **BOX 3: LEGAL ASPECTS OF PROJECT LOANS**

#### **1. Principal Obligation of Sovereign Borrowers:**

Pay the amount due plus covenants that “restrict abilities to engage in certain activities or to do certain acts”;

Waiver of Sovereign Immunity: allows lenders to sue the borrowing sovereign in foreign courts and for pre-judgment and post-judgment attachments. Under a pre-judgment attachment, a foreign court may order the seizure of the assets of the borrower located in its territory. The “order can be obtained without notice to the sovereign whose assets are to be seized”. A post-judgment attachment enables a judgement to be enforceable. The United States and Britain are the two principal jurisdictions to which sovereign borrowers are required to submit.

Waive the fungibility of financial credit: this implies that project loan is actually a flow of goods and services procured from the G7 at uncompetitive prices (some are 100% higher than international prices) and even if cheaper local resources are available. In other words, the borrowing nation must accept high cost of goods and services and it must discriminate against its firms and service providers even if they are cheaper.

#### **2. Objective of the Covenant**

“Achieve fair balance between the objective interests of the lender and borrower”.

#### **3. The Covenants:**

##### **(a) Negative Pledge Covenants**

- “Prohibits borrower from pledging its assets to secure another loan”
- “Prohibits the creation of security interests in favour of other creditors unless equal and retrievable security is granted to the creditor to whom the negative pledge is granted”. [The ban extends to agencies of the state]

- The lender’s (World Bank and IMF) negative pledge clause states that a lien (legal claim to asset of a debtor) be shared in proportion to the debt due each of them.

##### **Violations**

Results in penalties as included in the loan agreement[suspension of further Disbursement, acceleration of loan repayments, legal redress for breach etc].

##### **(b) Pari Passu Covenant**

- Prevents a borrower from subordinating the loan to any other unsecured debt i.e, borrower’s obligations will enjoy same status as its other obligations. [Prevents the borrower from discriminating between lenders by law or decree.

<p>However, the World Bank and IMF enjoys “preferred creditor status” that “rests On practical considerations rather than legal grounds and, thus, is not thought to Violate such countries” pari passu undertakings.</p>
<p>(c)Mandatory Prepayment Clause If a debtor repays debt of one creditor, it must make proportionate prepayments to All creditors.</p>
<p><b>4. Consequences of Default</b></p>
<p>Definition:</p>
<p>Any or all of the following constitute a default:</p>
<p>(a) failure to perform obligations under the lending arrangement; failure to pay when due or misrepresentations and violations of any of the covenants. (b) “general financial well being of the borrower, which makes it likely that the borrower will not be able to perform its payments obligations”</p>
<p><b>5. Penalties</b></p>
<p>(a) Failure to pay amounts when due; - negotiate grace period</p>
<p>-stoppage of disbursement and early recall of loan (b) Misrepresentations and Violations of any of the covenants -grace period could be negotiated to correct representation or comply with</p>
<p>covenants. (c) Cross-Default clause</p>
<p>– -a creditor can exercise remedies once a default occurs on any other lending arrangement</p>
<p>–triggered when other lenders accelerate their loans</p>
<p>(d) Material Adverse Change – lenders can end their commitment and accelerate their loans (e) Remedies -Acceleration; cancellation of remaining commitments and recall of loan -Other remedies; Rights to sue for unpaid amounts Injunctions and specific performance Set off: lay claim to financial assets of the borrower in the bank’s custody (f)Limits to Remedies -Mutual obligations -Act of State doctrine -Exchange control.</p>

Source: Adopted from Garba, A.G (2000) “The Economics of the Relations Between Official Lenders and Governments of SSA Countries”, presented at the millennium conference of the Nigerian Economic Society, Abuja, Nigeria. 11-12 September.

## **IMPLICATION OF LENDING POLICIES TO ECONOMIC DEVELOPMENT**

The conditions under which the World Bank and the IMF grants project loans, especially with regards to the obligations of sovereign borrowers such as financial repayment and covenants, which “restricts abilities to engage in certain activities or to do certain acts” is has deleterious effects to the fundamental requirements of development of countries. Not only do lenders grant credit at market rates, the loan agreement offers the lender a wide range of protection against default, discrimination, adverse material changes and false representation (Garba, 2000). The activities of the World Bank and the IMF are based on commerce and generate profit. Developmental needs cannot be met under the commercial lending arrangements, since it requires a long-term germination period and it is expected to generate diverse positive externalities that spill over to various aspects over the society.

The activities of the World Bank and IMF have given rise to a world capital market within an emerging world economic system that ascribes functions to various economies of the world in accordance with an international division of labour. The flow of capital around the world is being facilitated by the nature and dynamic operations of the international economic dispensation. The integration of the capital market is to ensure the movement of capital to the countries of the world where there is higher returns for capital, which enhances private capital gains. It is now widely recognized that finance capital responds rapidly to new profit opportunities on the basis of sound economic fundamentals. The World Bank and IMF have accentuated this process by incorporating liberalization policies as a major condition for providing assistance to countries that needs it. The significance of international trade in spearheading economic growth and development process underlies the essence of establishing formidable international trading rules to sustain the dispensation of the world economy. Institutional policy instruments are been used to consolidate the gains of free trade around the world. The formation of the General Agreements on Tariffs and Trade (GATT), which later metamorphosed into the World Trade Organisation (WTO), is to serve the purpose of

institutional policy framework for ensuring compliance with free trade policies by countries of the world towards achieving, sustaining and consolidating the globalised world economic structure.

Underdeveloped countries, which are not well equipped to produce goods and services that can withstand competition with others, are not likely to be interested in market expansion through international trade liberalisation. While availability of goods and services produced by firms motivates the need for wider markets, availability of markets in turn, provides impetus for further production of goods and services. Inspiration from economic growth and development analysis implies that effective use of resources, which is the critical stimulant for the process of economic growth and development, is hinged on industrial production. The most discernible characteristic of underdeveloped economies is lack of the infrastructure and motivation for the production of goods and services. This has constituted into a serious setback to industrial production in such countries, which has manifested into difficulties in meeting the basic needs of their domestic economies for goods and services. A cycle of persistent underdevelopment is emerging in these countries as a result of persistent non utilisation of their domestic resources for production purposes. To meet basic consumption requirements, demand for goods and services produced by other economies becomes inevitable, but development of any society evolves from the society's peculiar needs and the strategies towards meeting such needs by the society. Goods and services produced by other societies based on certain consideration have limitations in responding to developmental needs of another society. Due to lack of industrial production, the underdeveloped economies cannot reap the benefits of learning-by-doing and other positive externalities such as knowledge spillovers, Research and Development (R&D) and technological leapfrogging. The unutilised resources of the underdeveloped economies find their ways to the developed economies for use as raw materials for industrial production. The conditions for World Bank and IMF loans sustains trend. The rules governing loans granted to countries include the condition that projects to be financed must conform with certain arrangements some of which are the procurement from certain sources and the use of some expertises recommended by the lenders. According Encarta Encyclopedia 1995:

*“The (World) Bank grants loans to member nations, for the purpose of financing specific projects. Before a nation can secure a loan, advisers and experts representing the bank must determine that the prospective borrower can meet conditions stipulated by the bank”<sup>2</sup>*

This is at variance with the internal and evolutionary requisites of economic growth and development of underdeveloped economies by imposing on them policies that do not encourage industrial production. There has been a web of control around underdeveloped countries that has greatly eroded their national policy sovereignty. The rapid integration of financial markets has significant influence on national policy makers in the conduct of monetary and fiscal policies, which has tremendously undermined the achievement of macroeconomic stability of underdeveloped economies. This has also being a source of spreading shocks and disturbances from one financial market to the other. It also encroaches on the internal process of generating and sustaining the process of economic development by internal mechanisms of the society and eventually excludes a large section of the society from the process.

International capital flows have flourished through operations of the international capital market and underdeveloped countries have received a fair share of these flows. However, the flows of international capital to underdeveloped economies have not stimulated the process of economic growth and development because such flows are mainly in the form of official development finance, export credits, international bank loans, and bond issues with short-term maturity, which serves the purpose of facilitating the import dependent behaviour of the underdeveloped economies, rather than trigger a process of domestic production that could evolve into industrialization process. The foreign direct investment component of the flows are directed to the service sectors of the economy that have limited or even no linkage with the manufacturing sectors of the economy of the underdeveloped countries. International capital flows have been associated with high risk of volatility, which recently manifested in the East Asian financial crisis. The impact of the volatility of the international capital flows on the underdeveloped economies have culminated into persistent inflation, rise in interest rates, lagging wages and falling

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<sup>2</sup> International Bank for Reconstruction and Development, “Microsoft ® Encarta.



consumer demand. This has compounded the unfavourable investment climate of such economies. Uncertainties, falling demand and higher interest rates combine to cause a fall in investment, decline in GDP and rising unemployment, thereby paving the way for recession to set in (Obadan, 1999).

The pattern of international flows has been in accordance with the changing directions, signals and dictates of the forces of globalisation. For instance there was a burst in global capital flows following the collapse of the Bretton Woods system of fixed exchange rate in the early 1970s. Eatwell (1996) observed that, the fluctuating rate system that replaced it stimulated capital flows with a powerful cocktail of the carrot of speculative profit and the stick of financial risk, laced with the proceeds of extensive arbitrage. Other significant factors that led to the sudden and dramatic increase in capital flows in the 1970s were the two major oil price hikes and the need to recycle the attendant petrodollars. At the onset of the debt crises that afflicted most underdeveloped countries in 1982, capital flows dropped sharply and during most of the 1980s private financing to underdeveloped countries was at a standstill. In the 1970s, aggregate net resource flows maintained an upward trend, rising from \$21.1 billion in 1970 to \$162.1 billion in 1980 but declined in the 1980s to \$93.6 billion in 1985. In the 1990s, aggregate net resource flows to underdeveloped countries experience a rising trend, moving from \$101.9 billion in 1990 to \$284.6 billion in 1996, increased further to \$300.3 billion in 1997 against a favourable global environment marked by continued growth in demand from industrial countries, low inflation, moderately low interest rates, continued liquidity in international capital markets and strong economic performance of major borrowers (Obadan, 1999).

The worsening plight of most underdeveloped economies despite the phenomenal increase in international capital flows is indicative of the ineffective application of the flows to real productive investments that could stimulate the process of industrialization of such economies. Beside the need for appropriate macroeconomic environment to enhance the absorptive capacities of the underdeveloped economies, the strategic interest of domestic economies of the underdeveloped countries and that of owners of international capital are in conflict. An appropriate situation is when surges in capital

inflows are clearly attracted by sustainable improvements in competitiveness or potential productivity growth—so that the effects on activity, prices, and trade balance are less of signs of overheating than equilibrating adjustments—the policy response could be focused on improving the absorptive capacity of the economy rather than on containing the destabilizing effects (Schadler, 1994: 21). However, if policy makers in underdeveloped countries are made to be in tandem with the dictates of international lenders it will be difficult to create the requisite macroeconomic condition for effective utilization of both domestic resources and international capital flows. The situation has been worsened by a large quest for international capital flows by the underdeveloped economies as a major strategy of their economic development process. The rules binding international capital stifles domestic production and retards the growth of such economies. The attendant loss of policy making sovereignty has weakened the institutions of governance of underdeveloped countries and effective governance is a critical factor in motivating the domestic resources towards attaining economic growth and development. The governments of most underdeveloped countries give premium to satisfying the needs of the World Bank and IMF, while the needs of their citizenry (the electorates) are given secondary considerations. The absence of the crucial elements of responsive governance emanating from the overbearing influence of these lending institutions is fundamental to the lack of effective policy that could engender economic growth and development of underdeveloped countries. The imposition and consequent failures of such economic policy packages on these countries, such as the Structural Adjustment Programme (SAP) is very illustrative. The weakness of the governance process and the susceptibility of governments to the policies of the lending intuitions has enhanced corruption and lack of accountability by governments of weaker nations to their citizens. This phenomenon is more applicable to Sub-Saharan African (SSA) countries, which remain the most underdeveloped region of the world. In its publication in 1989, *Sub-Saharan Africa: From Crisis to Sustainable Development*, the World Bank asserted that “Underlying the litany of Africa’s development problems is a crisis of governance. By “governance”, it is meant the exercise of political power to manage a nation’s affairs”. Ironically the World Bank does not see its role in the crisis of governance that is

afflicting these countries and that has tremendously hindered their economic growth and development.

## CONCLUSION

The challenges of economic development for underdeveloped countries in the face of growing assertiveness of the World Bank and IMF are very gargantuan. Considering that economic development is attained through the utilisation of available resources to enhance the social and economic well-being of the society, it is only the people in any society that can generate and sustain economic development. Countries are expected to provide essential services to the large spectrum of the society in a regenerating process of discovery and widening the scope of its dispensation towards an integrated and cohesive national economy in which linkages between various sectors and regions are entrenched such that every member of the society is given a fair opportunity to advance his/her material condition. It follows that industrialisation is a necessary step towards attaining economic development, which requires a sound and encompassing macroeconomic policy implementation to flourish.

However, the activities of the World Bank and IMF, through their lending policies infringes on the ability to implement internally cohesive macroeconomic policies for developing countries since they are to adhere to the basic rules of the international economic system. There is therefore the lack of policy autonomy as a result of *tying the hands of weak countries* and in macroeconomics, policy autonomy is critical to the size of policy multipliers. There are therefore two main sources of the challenge to economic development that underdeveloped countries are contending with; one is to identify the needs of their society and motivate the society towards providing these needs in a sustainable industrialisation process; second is to absorb the increasing pressure from international lenders to adopt certain prescribed policies, which are in conflict with the needs of their society. In order to be able to establish a process for attaining economic development, underdeveloped countries should strive to extricate themselves from the vestiges of external creditors so as to be able to initiate and implement far reaching

macroeconomic policies that are suitable for their circumstances and developmental needs.

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